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MEMORANDUM

Date: November 15, 2001

To: All Chapter 7 Panel Trustees
All Chapter 13 Standing Trustees

From: Maureen A. Tighe *Maureen A Tighe*
United States Trustee
Region 16

Re: United States Trustee Policy on Fees Claimed by Chapter 7 Trustees and Their Professionals in Cases Converted to Chapter 13

I. INTRODUCTION

The issue of cases converted from chapter 7 to chapter 13 has increasingly become an important topic of discussion between the U.S. Trustee's office and the trustees. For example, we previously discussed methods to combat situations where debtors converted their cases to chapter 13 to avoid the chapter 7 trustee's efforts to recover and liquidate assets, in the hope that automatic dismissal could be achieved in the chapter 13. There, the focus was on finding methods to reconvert such cases to chapter 7 rather than allowing them to be dismissed. The focus of this memo is to address a different, but related issue arising in such cases, when they are not reconverted: what, if any, is the appropriate method and formula for payment to chapter 7 trustees and their professionals where substantial and valuable services have been provided to the estate prior to conversion, but no compensation has been received?^{1/}

^{1/}In such cases, the trustee has usually not received any funds prior to conversion, which raises not only practical issues of non-payment but also issues regarding the 11 U.S.C. § 326 cap on the trustee's fee.

At this time, we believe that some form of compensation to the chapter 7 trustee and his/her professionals is sometimes appropriate in such cases, notwithstanding (1) the lack of receipts or disbursements by the chapter 7 trustees, (2) the fact that the case law in this area is not consistent, and (3) the fact that current practices among the chapter 7 trustees in this district vary and are not always consistent with the Bankruptcy Code ("Code"), Federal Rules of Bankruptcy Procedure ("FRBP's"), and Local Bankruptcy Rules ("LBR's"). In this memo, *subject to further developments in the case law or enactment of bankruptcy reform legislation affecting this area*, we set forth the methods and formula for obtaining compensation that we believe are most consistent with the Code and Rules, which if followed should help to minimize objections by this office and by the Standing Trustees in the cases that they administer.^{2/}

II. CURRENT PRACTICES AMONG CHAPTER 7 TRUSTEES AND RELATION TO RELEVANT PROVISIONS OF BANKRUPTCY CODE AND RULES

Over the years, the chapter 7 trustees have devised several creative methods to obtain payment for their services or for the services of their professionals in cases converted to chapter 13 and not reconverted back. These methods include (1) filing "proofs of claim" together with objections to chapter 13 plans for non-inclusion of those "claims," (2) stipulations with debtors for payment of a sum certain, and (3) motions for payment of an administrative claim. We believe, however, that only the latter method comes close to complying with the relevant requirements of the Code, the FRBP's, and the LBR's.^{3/}

^{2/}Of course, this memo should not be seen as an invitation to seek compensation in all chapter 7 cases converted to chapter 13. Compensation is only appropriate in circumstances similar to those described in *In re Hages*, 252 B.R. 789, 793-94 (Bkrtcy. N.D. CA. 2000), where the trustee performed substantial services that generated value for unsecured creditors. Put another way, the mere conversion of a case from chapter 7 to chapter 13 should not trigger a fee where none would otherwise be appropriate.

^{3/}The relevant statutory provisions governing compensation and reimbursement of professionals, of course, are Code §§ 326 (statutory cap on chapter 7 trustees' fees), 327 (requiring prior court approval of employment of professionals as pre-requisite for payment of fees, see also *In re Shirley*, 134 B.R. 940, 943-44 (9th Cir. B.A.P. 1992) ("Court approval of the employment of counsel for a debtor in possession is the sine qua non to counsel getting paid. . . [f]ailure to receive Court approval for the employment of a professional in accordance with § 327 and Federal Rule of Bankruptcy Procedure 2014 precluded payment of fees.")), and 328-331 (standards for compensation and reimbursement). The relevant rules include FRBP's 2002(a)(6) (full notice to all creditors, etc., when fee and expense request exceeds \$1,000), 2014 (requirement of application for employment), and 2016 (requirement of application for compensation or reimbursement), along with LBR's 2014-1 (standards and procedures governing applications for employment), 2016-1

The proof of claim method, while providing a desirable level of convenience to the trustees, has no basis in law. Professionals owed fees by an estate are holders of administrative *expenses*, not *claims*.^{4/} Hence, they must file a "request" for payment of that expense, pursuant to 11 U.S.C. § 503. The proper procedure for professionals making such requests is the filing and noticing of a fee application under Code §§ 503(b)(2) and 330-331, FRBP's 2002(a)(6) and 2016, and LBR 2016-1. The proof of claim procedure simply fails to comport with either the substantive standards of these provisions, or the provisions regarding notice and an opportunity to object. Incidentally, those proofs of claim that we have seen from chapter 7 trustees and their professionals in these cases typically contain very little or none of the information or backup required in fee applications.

The next method we have seen is stipulations with debtors for payment of a sum certain, with the stipulated amount included in the debtor's plan. Apart from causing the appearance that the debtor has warded off the chapter 7 trustee's pursuit of reconversion by agreeing to the payment, such stipulations also suffer from many of the same deficiencies as proofs of claim. These stipulations are typically not noticed to all parties entitled to notice of fee applications. They are not set for hearing, nor filed under the LBR procedure for motions without a hearing, with an opportunity to object and request one.

The third method we have seen used is the filing of motions for court approval of the payment of an administrative expense or "claim." To the extent that such motions (1) are properly noticed to all entities entitled to notice of fee applications, and (2) provide similar information to that which would be required in such applications, the above concerns are lessened considerably. Unfortunately, these motions are often cursory and fail to meet the required standards. Nevertheless, those trustees who use this method are on the right track.

(standards and procedures governing fee applications, including 24 days notice provision), 9013-1(g)(1)(N) (allowing matters to be considered without a hearing on notice and opportunity to object and request a hearing), and 3015-1(u)(1) and 3015-1(v)(3) (in chapter 13 cases, no hearing required on applications for supplemental fees unless requested; notice to all creditors, etc. required only where fee/expense request exceeds \$1,000 (raised from \$500 to comport with FRBP 2002(a)(6), per General Order 01-02 entered April 10, 2001), with notice only to Chapter 13 trustee, debtor, debtor's attorney, and U.S. Trustee when fees are under that amount).

^{4/}See Levinson, "Does an Administrative Expense Constitute a 'Claim' Under the Bankruptcy Code?" and cases cited therein. Vol. 25 Cal. Bankr. J. No.3 (2000).

Regardless of which of the above three methods is utilized, one final and very important issue remains. With regard to the chapter 7 trustee's fee, the lack of disbursements in the chapter 7 phase of converted cases has led to confusion and the lack of a standard over how the fee should be calculated.^{5/} Although the trustees have typically billed their time on an hourly basis in such cases, this is only half the equation. No attempt (that we are aware of) has been made in this district to reconcile the request with Code § 326, such as to avoid over-compensating the trustee for doing less work than would otherwise be done if the case had not been converted to chapter 13 (with the trustee forced to complete its administration). This issue must be addressed.

In short, while we agree that the chapter 7 trustee should be compensated in such cases despite the lack of disbursements, we also believe that there should be a consistent and reasonable standard for calculating the fee, and that it should comport with the Code and Rules.

III. U.S. TRUSTEE POLICY AND RELATION TO PROVISIONS OF BANKRUPTCY CODE AND RULES

A. Procedures for Obtaining Court Approval of Applications for Fees and Expenses

Some type of noticed motion, application, or request for court approval of the payment of an administrative expense should be filed by chapter 7 trustees and their professionals who seek compensation and reimbursement of expenses in cases converted to chapter 13. The most obvious method would be to follow the usual procedures for the filing of final fee applications, on 24 days notice to all entities entitled to notice under FRBP 2002(a)(6) and LBR 2016-1. Such an application would typically contain that information ordinarily required to be included in fee applications under the Code, Rules, and U.S. Trustee's Fee Guide. On the other hand, we recognize that the amount of fees requested by the chapter 7 trustees and their professionals in such cases is often small, sometimes as little as a few hundred dollars or less, which may not justify the inclusion of the ordinary level of detail in the applications. Moreover, we do not wish to unnecessarily increase costs for chapter 13 debtors. Under such circumstances, a full-blown fee application would seem impractical and unnecessary. Nevertheless, clear consistent guidelines are necessary.

^{5/}In contrast, fees for attorneys or accountants can simply be calculated as usual, typically hourly (i.e., the so-called "lodestar" method).

Given the foregoing, my office's position is that a fee application filed under the provisions of LBR 9013-1(g)(1)(N) in these cases (allowing matters to be heard without a hearing on 15-day notice and an opportunity to object) is appropriate in most circumstances. This will be true where the fees and expenses requested do not together exceed \$3,000 for the trustee or for any given professional (i.e., \$3,000 per professional). Moreover, where fees and expenses requested do not exceed \$1,000, notice need be given only to the chapter 13 trustee, the debtor, the debtor's attorney (if any), and to the U.S. Trustee, consistent with FRBP 2002(a)(6) and LBR's 3015-1(u)(1) and 3015-1(v)(3) (as amended by General Order 01-02).^{6/}

As for content, the U.S. Trustee believes a simplified fee application is appropriate where the fees and expenses do not exceed the \$3,000 figure above.^{7/} In such cases, the U.S. Trustee and/or the Standing Trustees will generally not object solely on the basis that all of the ordinary requirements of the U.S. Trustee's Fee Guide (i.e., categories, monthly breakdowns, etc.) are not included. Such fee applications, however, must contain at least a general narrative of the services provided and the benefit to the estate, plus detailed time entries for fees and a detailed listing of expenses.^{8/} Other items required by LBR 2016-1 should be included as applicable, such as date of entry of employment order, etc.^{9/} Notwithstanding the foregoing, the U.S. Trustee and the

^{6/}To the extent that a stipulation (and order) can be obtained from all parties required to be served with such a motion/application, the U.S. Trustee's position is that 15-day notice with an opportunity to object and request a hearing is not necessary. It is expected that such stipulations would most often occur in cases where the fees/expenses requested do not exceed \$1,000, simply because all creditors need not be served with notice of the motions/applications, and hence need not be parties to the stipulation.

^{7/}This is intended to somewhat track the UST's Handbook for Chapter 7 Trustees (March 1, 2001), chapter 8(N)(1), page 8-29 (stating that "...local rules and practices sometimes provide that time records need not be submitted if the compensation request is under a specified amount"), and the UST's Chapter 7 Asset Case Closing Procedures, § II(B), page 6 (requiring Trustee Time Record (Exhibit 8) "...only for cases in which the statutory fee requested by the trustee exceeds \$3,000.00"). Of course, in chapter 7 cases the presumption is that the trustee completed administration of the case, unlike here, such that more justification of the fee is required here than in a completed chapter 7.

^{8/}This includes the chapter 7 trustee's fee application; see fn 7 above.

^{9/}Only professionals (other than the trustee) whose employment was approved in the chapter 7 (or can otherwise obtain retroactive approval of their employment for that phase of the case) are eligible to seek fees/expenses. See *In re Shirley*, 134 B.R. 940, 943-44 (9th Cir. B.A.P. 1992), and fn 3 above.

Standing Trustees reserve the right to request that further information be provided as to any fee application, as they deem appropriate.

For fee/expense applications exceeding \$3,000, the U.S. Trustee believes that a hearing under the normal procedures of LBR 2016-1 and the U.S. Trustee's Fee Guide is necessary (i.e., on 24 days notice), and that all information normally required by the Fee Guide and Local Rules must be included.

B. Method for Calculation of Trustee's Fee

As noted above, the fees of professionals other than the trustee can be calculated as usual (typically hourly). However, calculation of the chapter 7 trustee's fee is more complicated, due to the statutory cap on trustee's fees set forth in 11 U.S.C. § 326, as well as the typical paucity or total lack of disbursements by the trustee prior to conversion of the case to chapter 13. In addition, the case law in this area is inconsistent, with some cases essentially utilizing an *ad hoc* approach to calculating the fee, others using *quantum meruit* as the standard, and still others utilizing hourly rates, possibly subject to what would have been the statutory maximum if the case had remained in chapter 7. Some cases deny a fee altogether on the basis that the chapter 7 trustee made no disbursements while the case was in chapter 7.^{10/} We do not believe that any of these methods comport with the Code or Ninth Circuit case law in the area of professional and trustee's fees.

One fairly recent case, *In re Hages*, 252 B.R. 789 (Bkrtcy. N.D. CA. 2000), is more persuasive and at least attempts to reconcile the issues with Ninth Circuit case law, while furthering the policy of compensating chapter 7 trustees who perform substantial and valuable services for the estate but are thwarted from completing their work due to the conversion of the case by the debtor to chapter 13. In a nutshell, the decision provides that where substantial and valuable services have been provided to the estate by the chapter 7 trustee,^{11/} (1) the statutory cap of § 326 does apply despite no funds having been disbursed by the chapter 7 trustee; (2) the cap is to be calculated based on anticipated disbursements by the chapter 13 trustee under the debtor's plan; (3) the cap is a cap and not an entitlement, with the Court retaining discretion to award a lesser amount or to deny fees altogether; and (4) fees are to be calculated under the usual

^{10/} See Jones, "'How to Pay a Chapter 7 Trustee When the Case Converts to Chapter 13' or 'Do I Have to Pay the Chapter 7 Trustee?'" and cases cited therein. Vol. 3, No. 1, NACTT Quarterly (October/November/December 2000).

^{11/} See fn 2 above.

"reasonable, actual and necessary" standard of Code § 330. Consistent with these standards, the *Hages* court concluded that the trustee there would be awarded \$1,530 in fees at her normal hourly rate (5.1 hours x \$300/hour), but would not be awarded the statutory maximum, or \$2,111.30, because she had shown no basis for an award in excess of a reasonable hourly rate. 252 B.R. @ 799.

Based on the foregoing, it is the policy of this office that chapter 7 trustees' fees in cases converted from chapter 7 to chapter 13 should conform to the method of calculation set forth in *Hages*; i.e., that a reasonable hourly rate, subject to the statutory cap of § 326, should apply. In most cases, where the amount is fairly small, this should be fairly simple to determine.

C. Compensation of Brokers

Some trustees in converted cases have sought payment of fees and expenses for real estate brokers hired on a commission basis in the chapter 7 phase of the case, even though the property they were hired to list was never sold due to the conversion of the case to chapter 13. This is inappropriate as there is no basis for compensating them or reimbursing their expenses when no sale takes place. Despite the fact that the brokers may have expended money on advertising or other costs, and spent some of their time on the case, it is the nature of their industry that no compensation be received in the absence of a sale. At the same time, the converse is also true - they receive full payment no matter how quick or "easy" the sale is. Hence, by asking for payment when they are prevented from selling a property due to a debtor's conversion of the case (or dismissal for that matter), they risk being asked to cut their fees when a property is sold quickly such that their expenditure of time and costs is less than normal. This occurs very rarely, if ever, because the U.S. Trustee and other parties understand that the nature of the real estate business is such that brokers will sometimes be "overpaid" in the case of a quick, easy sale, while "underpaid" in the case of a slow, difficult sale (or not paid at all if no sale can be consummated).

Therefore, the trustees should not seek fees and expenses for their brokers in these situations. Moreover, provisions in chapter 7 employment applications for such payment in the event of conversion to chapter 13 will be objected to by the U.S. Trustee.

D. Timing of Fee Applications and Chapter 13 Plan Issues

Certain practical considerations should be taken into account in filing the above fee applications in converted cases, regardless of the method used. Although not intended as a full recitation of

the various nuances of the chapter 13 confirmation and plan payments process, the chapter 7 trustees and their professionals should keep in mind at least the following when filing their fee applications:

1. Payment on their administrative "claims" (more accurately, "expenses") will be paid as provided in the plan, if included therein (assuming, of course, that the fees/expenses have been allowed by the court). This could mean, for example, "up-front" payment, or payment over time. Therefore, the trustees should ensure that their claims are included in the plan or object to the plan if not included; and

2. Notwithstanding inclusion in a plan, for timing/allowance reasons trustees and their professionals should file their fee applications as soon as possible after conversion of the case to chapter 13 so that they may be approved prior to confirmation, or set for hearing on the same date and time as the confirmation hearing. Failure to do so impacts the chapter 13 trustee's feasibility analysis and may lead to an objection by him or her on the basis that the fees have not yet been approved by the court, or, in the case of a fee application filed after confirmation, that the plan is rendered unfeasible by the request, etc. Another possibility in such situations is that even if the fees are allowed, they might not be paid until after all scheduled secured and priority debts are paid in full.

IV. CONCLUSION

In summary, the following guidelines should be followed when seeking fees and expenses in a case converted from chapter 7 to chapter 13 in order to minimize the likelihood of an objection by the U.S. Trustee or Standing Trustee:

1. To be eligible for payment of fees/expenses, all professionals (other than the trustee, of course) must be or have been properly employed by court order in the chapter 7 phase of the case pursuant to 11 U.S.C. § 327, FRBP 2014, LBR 2014-1, and *In re Shirley*, 134 B.R. 940, 943-44 (9th Cir. B.A.P. 1992), and must have their fees/expenses allowed by the court (including the trustee).

2. Where fees/expenses do not exceed \$3,000, a court order approving compensation and reimbursement of expenses may be sought by properly noticed motion/application/request pursuant to FRBP 2002(a)(6), LBR 2016-1, and LBR 9013-1(g)(1)(N) (no hearing required; notice to all creditors where fee/expense request exceeds \$1,000; notice only to Chapter 13 trustee, debtor, debtor's attorney, and U.S. Trustee where fees/expenses do not exceed

\$1,000). To the extent that a stipulation can be obtained from all parties required to be served with such a motion, 15-day notice and opportunity to object and request a hearing is not necessary. Streamlined content is acceptable where fees/expenses do not exceed the \$3,000 figure, subject to the U.S. Trustee's and the Standing Trustees' right to request further information as they deem appropriate. Where fees/expenses exceed \$3,000, a fully noticed hearing on 24 days notice, with normal information required in fee applications, is necessary.

3. Fee/expense requests by trustee's professionals must comply with the standards set forth in Code §§ 328 and 330-331, LBR 2016-1, and the U.S. Trustee's Fee Guide (subject to the provision for streamlined content when the request does not exceed \$3,000).

4. Fee requests by chapter 7 trustees must comply with the standards set forth in Code §§ 326, 328, and 330-331, as well as the usual chapter 7 rules, to the extent applicable in this context (see, e.g., LBR 2016-2). The fee should be calculated according to the method set forth in *In re Hages*, 252 B.R. 789 (Bkrtcy. N.D. CA. 2000) (i.e., a reasonable hourly rate, subject to the statutory cap of § 326).

5. Trustees and their professionals should file their fee applications as soon as possible following conversion to chapter 13 so that they may be approved prior to confirmation or set for hearing therewith. They should also make sure that their claims are included in the debtor's plan or object to the plan if not included.

Please contact U.S. Trustee staff attorney Joseph E. Caceres at (213) 894-4301 with any questions you may have regarding the foregoing.

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